



**MCI Telecommunications
Corporation**

1801 Pennsylvania Avenue, N.W.
Washington, D.C. 20006

May 14, 1996

Mr. William F. Caton
Secretary
Federal Communications Commission
Room 222
1919 M Street, N.W.
Washington, D.C. 20554

DOCKET FILE COPY ORIGINAL

Re: **Amendments to Part 65, Interstate Rate of Return Prescription
Procedures and Methodologies, Subpart G, Rate Base; CC Docket No.
96-22; AAD 92-56**

Dear Mr. Caton:

Enclosed herewith for filing are the original and four (4) copies of MCI
Telecommunications Corporation's Reply Comments in the above-captioned docket.
Please acknowledge receipt by affixing an appropriate notation on the copy of the MCI
Reply Comments furnished for such purpose and remit same to the bearer.

Sincerely yours,

Alan Buzacott
Regulatory Analyst

Enclosure
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**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554**

RECEIVED
MAY 14 1996

In the Matter of:

**Responsible Accounting Officer Letter 20
Uniform Accounting for Postretirement
Benefits Other Than Pensions in Part 32**

**Amendments to Part 65, Interstate Rate of
Return Prescription Procedures and
Methodologies, Subpart G, Rate Base**

**CC Docket No. 96-22;
AAD 92-56**

MCI REPLY COMMENTS

I. INTRODUCTION

MCI Telecommunications Corporation (MCI) hereby submits its reply comments in the above-captioned docket. In the OPEB NPRM,¹ the Commission requested comments on proposed modifications to Sections 65.820(c) and 65.830(a) of the Commission's rules. These modifications would have the effect of giving postretirement benefits other than pensions (OPEBs) the same rate base treatment as ordinary pensions. The modified Section 65.820(c) would specify that prepaid OPEB costs included in Account 1410 are to be included in the rate base, while the modified Section 65.830(a) would specify that all unfunded accrued liabilities included in Account 4310, including those related to OPEBs, would be excluded from the rate base. In its comments, MCI

¹ In the Matter of Amendments to Part 65, Interstate Rate of Return Prescription Procedures and Methodologies, Subpart G, Rate Base, CC Docket No. 96-22, Notice of Proposed Rulemaking, released March 7, 1996 (OPEB NPRM).

~~CONFIDENTIAL~~

fully supported the rule changes proposed in the OPEB NPRM.

Several parties submitted comments in the above-captioned proceeding. Only two parties, Bell Atlantic and Ameritech, specifically opposed the Commission's proposal to exclude unfunded accrued OPEB liabilities from the rate base. US West, NYNEX, and BellSouth, while not opposing the proposal to exclude unfunded accrued OPEB liabilities, expressed concern about certain aspects of the Commission's proposal. In particular, US West and NYNEX opposed the Commission's proposal to exclude automatically all items in Account 4310 from the rate base.

II. THERE IS NO LINK BETWEEN THE RATE BASE TREATMENT AND EXOGENOUS COST TREATMENT OF OPEB LIABILITIES

In the OPEB NPRM, the Commission stated that the proposed rule changes were motivated by a continuing concern that zero-cost sources of funds be removed from the rate base. In their comments, Bell Atlantic and Ameritech claim that the accrued OPEB liabilities cannot constitute a zero-cost source of funds because the Commission has precluded LECs from reflecting OPEB costs in their rates.² They argue, first, that OPEB costs were not reflected in rates at the inception of price caps and, second, that the Commission has disallowed adjustments to price cap indexes that would compensate for increased OPEB costs.

In effect, Ameritech and Bell Atlantic seek to revisit the Commission's decision to preclude exogenous cost treatment for the accounting rule changes specified in Statement

² Ameritech Comments at 2-3; Bell Atlantic Comments at 3.

of Financial Accounting Standards No. 106 (SFAS-106). In the Price Cap Review Order, the Commission found that the accounting changes required by SFAS-106 altered the timing of the recognition of OPEB costs but did not change the LECs' economic costs.³ The introduction of SFAS-106 had no effect on price cap LECs' discounted cash flows or, consequently, their ability to attract investor capital.⁴ There is no reason to address the exogenous cost treatment of OPEB liabilities again in this proceeding.

Moreover, the correct rate base treatment of OPEB liabilities does not depend on whether these costs are considered exogenous. Rate of return calculations are based on the accounting definition of cost, not the economic cost criterion that the Commission employs to determine whether exogenous treatment is warranted. As a result, the Commission is required to scrutinize accounting rule changes to determine whether their impact on LEC rate of return is consistent with its regulatory objectives. In the case of SFAS-106, the change from cash to accrual accounting for OPEBs, in the absence of rule changes as proposed by the Commission, has the effect of increasing the amounts that LECs record in their accounting records for expenses, potentially reducing the sharing obligation of price cap LECs. While the recorded amount of expense increases as a result of SFAS-106, the LECs actual out-of-pocket expenses do not increase. In order to prevent SFAS-106 from influencing reported earnings or sharing obligations, it is essential that the Commission modify its rules, clarifying that unfunded accrued OPEB liabilities are

³ In the Matter of Price Cap Performance Review for Local Exchange Carriers, First Report and Order, 10 FCC Rcd 8961, 9095 (Price Cap Review Order).

⁴ Id. at 9091.

to be excluded from the rate base.

It is not arbitrary for the Commission to exclude OPEB costs from the rate base at the same time that it disallows exogenous recovery of OPEB costs, as Bell Atlantic claims.⁵ Under the Commission's price cap plan, designed to mirror the efficiency incentives of a competitive market, exogenous adjustments to the PCI are required only for changes in economic costs. Typically, accounting changes do not change economic costs, and therefore do not require an adjustment to LEC PCIs. However, because the Commission's plan continues to include some elements of rate of return regulation in the sharing and low-end adjustment mechanisms, the methodology for calculating rate of return must be adjusted to accommodate accounting rule changes. The Commission's proposed rule changes would not increase LECs' sharing obligation "artificially," as Bell Atlantic argues, but would prevent an accounting rule change from causing an artificial decrease in their sharing obligation.⁶

III. THE RATE BASE TREATMENT OF ITEMS IN ACCOUNTS 1410 AND 4310 SHOULD DEPEND ON WHETHER THEY ARE ZERO-COST OR INVESTOR-SUPPLIED FUNDS

The principle that zero-cost sources of funds should be excluded from the rate base is well-established. Indeed, MCI continues to believe that the Common Carrier

⁵ Bell Atlantic Comments at 1.

⁶ Id.

Bureau's statement in Responsible Accounting Officer Letter 20 (RAO 20)⁷ concerning the rate base treatment of OPEB liabilities was a reasonable interpretation of existing Commission rules.⁸ Nonetheless, MCI supports the Commission's proposal to modify its Part 65 rules to, at a minimum, clarify that OPEBs should be excluded from the rate base.

In the OPEB NPRM, the Commission also asks whether it should exclude other items in Account 4310 from the rate base. MCI concurs with the comments of US West, which proposes that the Commission adopt a policy stating that the rate base treatment of items in accounts 1410 and 4310 will depend on whether these items constitute zero-cost or investor-supplied funds. A clearly-stated policy governing the rate base treatment of items in accounts 1410 and 4310 would eliminate the need for the Commission to modify its Part 65 rules after every accounting rule change affecting these accounts. The current approach, requiring the Commission's rate base rules to explicitly include or exclude specific items, is inflexible and results in time-consuming proceedings whenever accounting rules change.

IV. THERE IS NO REASON TO DELAY THE PROPOSED RULE CHANGES

In the OPEB NPRM, the Commission requests comments on whether or not it should defer the rule changes until it concludes its investigation into LEC tariffs that

⁷ Uniform Accounting for Postretirement Benefits Other Than Pensions in Part 32, 7 FCC Rcd 2872.

⁸ See MCI Petition for Reconsideration, In the Matter of Responsible Accounting Officer Letter 20, Uniform Accounting for Postretirement Benefits Other Than Pensions in Part 32 (filed April 8, 1996).

included exogenous adjustments for OPEB costs. No parties filed comments supporting a delay. MCI concurs with AT&T's comments urging the Commission to act expeditiously to amend its rules. The proposed rule changes would have no effect on the tariff investigation, which is concerned only with rates in effect between 1993 and 1995. The 1995 Annual Access Order⁹ required all LECs that had not already done so to remove OPEB costs from their interstate access rates.

V. CONCLUSION

The Commission should adopt a rule that removes all zero-cost sources of funds in Account 4310, including unfunded accrued OPEB liabilities, from the rate base.

Respectfully submitted,
MCI TELECOMMUNICATIONS CORPORATION



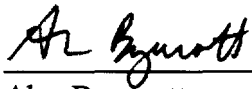
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May 14, 1996

⁹ In the Matter of 1995 Annual Access Tariff Filings of Price Cap Carriers, Memorandum Opinion and Order Suspending Rates, DA 95-1631, released July 21, 1995 (1995 Annual Access Order).

STATEMENT OF VERIFICATION

I have read the foregoing and, to the best of my knowledge, information, and belief, there is good ground to support it, and it is not interposed for delay. I verify under penalty of perjury that the foregoing is true and correct. Executed on May 14, 1996.

A handwritten signature in cursive script, appearing to read "Alan Buzacott", is written over a horizontal line.

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CERTIFICATE OF SERVICE

I, Stan Miller, do hereby certify that copies of the foregoing Reply Comments were sent via first class mail, postage paid, to the following on this 14th day of May, 1996.

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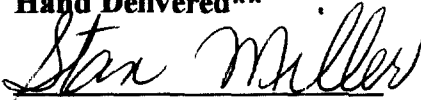
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